



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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CIVIL DIVISION

B-114826

APR 14 1971



Dear Mr. Carlson:

Our examination of the financial statements of Federal Prison Industries, Inc. (FPI), for fiscal year 1970 included examinations at the central office in Washington, D.C., and at five institutions located at Danbury, Connecticut; McNeil Island, Washington; Seagoville, Texas; Tallahassee, Florida; and Terminal Island, California.

We observed certain practices which required the attention of local officials. These practices were brought to their attention, and copies of our letters to these officials were made available to you. In addition, we found that there was a need to revise certain accounting, procurement, and other practices requiring corrective action by the central office. These matters are discussed below.

QUESTIONABLE AWARD OF
VOCATIONAL TRAINING CONTRACTS

During fiscal year 1970 the central office entered into two negotiated contracts for services to be performed at the Federal Reformatory for Women at Alderson, West Virginia. On August 4, 1969, the central office negotiated a \$50,000 contract with Keyboard Training, Inc. (KTI), to teach 100 inmates at Alderson keypunch skills, office routines, and interviewing techniques. In the following month the contract was increased to about \$66,000 to provide for the rental, shipping, and related costs of 14 keypunch machines. On March 9, 1970, the central office negotiated a contract in the amount of \$6,840 with Urban Resources, Inc. (URI), to perform an evaluation of the impact of the training received under the KTI contract.

The FPI manual provides that Federal Procurement Regulations be applicable to FPI. The regulations provide that no procurement in excess of \$2,500 shall be made by negotiation if the use of formal advertising is feasible and practicable under the existing conditions. In our opinion the contracts with KTI and URI should have been awarded on the basis of formal advertising.

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B-114826

In addition, the central office administratively determined that the costs of the two contracts were to be charged to central office accounts: 80 percent to account 63, Other Expense; and 20 percent to account 61, Vocational Expense. We believe that 80 percent of the costs should have been recorded as a cost of operating the ADP industry at Alderson and that 20 percent should have been recorded as part of Alderson's vocational training expense.

We recommend that you take the action necessary to ensure that Federal Procurement Regulations are complied with and that the need for entering into negotiated contracts is fully justified. We recommend also that central office employees be instructed to transfer the costs of the KTI and URI contracts to the proper accounts at Alderson.

BILLING FOR PRODUCTS FURNISHED
DELAYED UNTIL FOLLOWING FISCAL YEAR

The electronics industry at McNeil Island furnished products having a sale value of about \$229,000 to the U.S. Army Mobility Equipment Command in April and May of 1970. Fourteen days after the first shipment was made in April 1970, the Army requested that it not be billed for the products until July 1, 1970. A marketing specialist in the central office approved the Army's request, and the electronics industry delayed billing the Army until the following fiscal year.

It appears that the Army used fiscal year 1971 funds to purchase products received in fiscal year 1970. In our opinion this action circumvented congressional control over funds appropriated for fiscal year 1970. FPI's agreement to delay the billing does not appear to have been in the best interest of the Government or to have been an aid in congressional control over appropriated funds.

We recommend that you take the action necessary to ensure that billings are not delayed for the convenience of FPI's customers or at their request.

INADEQUATE PLANNING FOR
INCREASE IN ELECTRIC POWER

The FPI manual requires special authorizations by the central office for the construction, alteration, improvement, addition, and replacement of buildings, except for items of a minor routine nature.

In October 1969 the central office approved a special authorization in the amount of \$18,550 to purchase transformers, electrical cable, and related equipment and to pay for the cost of labor to install the transformers for increasing the electric power for the sign shop at McNeil Island.

In December 1969 an official from the Bureau of Prisons inspected the overall electrical system of the furniture factory building, which also housed the sign shop, and determined that the electrical wiring in the building was very hazardous and had been installed in violation of the National Electrical Code. It was his opinion that the wiring should be corrected and installed in accordance with the code requirements. A local FPI official estimated that the overall electrical improvements would cost about \$200,000. At the time of our review, about \$11,000 had been expended on the original program for increasing electric power, including about \$2,000 for items purchased but not usable under the rewiring program.

We recommend that you issue instructions to revise the ~~B~~ FPI manual to include a provision requiring that, before special authorizations for major construction, alterations, and additions are approved, central office employees discuss the proposed project(s) with the Construction and Mechanical Branch, Bureau of Prisons, to obtain advice and guidance. ~~2~~

PREMATURE PURCHASE OF A CAMERA

In March 1970 the central office authorized the purchase of a process camera for the sign shop at McNeil Island. The camera, purchased for about \$5,400, was received on June 16, 1970.

B-114826

At the time of our review in September 1970, the camera had not been unpacked and was stored in a warehouse because space was not available to install the camera. FPI at McNeil Island planned to move its business office to the warehouse area and to install the camera in the former business office area. Officials at McNeil Island estimated that it would be from 6 to 12 months before the camera could be installed.

The 90-day portion of the warranty on the camera, providing for repair or replacement of defective parts at no cost, expired on September 14, 1970. The remaining portion of the warranty, providing for repair or replacement at no cost for parts but with charges for labor, service, and transportation, will expire on June 16, 1971.

In our opinion the camera was purchased prematurely. At the time of our examination, an installation date had not been established. As a result FPI has lost some, and may lose more, of the benefits provided by the warranty.

NEED TO REVISE ACCOUNTING
FOR CHANGES TO ASSETS

Two of the five institutions included in our examination amortized capital improvements over a relatively short period of time, although the improvements enhanced the value and extended the life of the assets.

Officials at Tallahassee, Florida, on the basis of central office instructions, charged about \$23,000 to account 40, Deferred and Prepaid Expense, and provided for amortization of the costs over a 4-year period for FPI's share of an electrical rehabilitation project at its vocational training facilities. The rehabilitation increased the value of the buildings by additions to the then-existing electrical system.

The electronics shop at McNeil Island repaired a forklift. This repair increased the forklift's value and extended its life. On the basis of central office approval, the cost of the repairs of about \$2,400 was charged to account 40 to be

B-114826

amortized over a 3-year period, rather than added to the value of the forklift.

The basic principle to be observed in accounting for an alteration, replacement, or other improvement to an existing asset which significantly prolongs its useful life is to capitalize the costs incurred and to depreciate the costs over the remaining life of the asset. Accordingly, we recommend that you issue instructions to incorporate this accounting principle in the FPI manual.

IMPROVEMENT IN ALLOCATING LABOR AND OVERHEAD
TO THE WORK-IN-PROCESS INVENTORY

In our previous years' examinations we found that direct labor and overhead costs had not been allocated to the work-in-process inventory at year-ends. It was our opinion that the financial position of the corporation would have been more accurate if these costs had been included in the work-in-process inventory rather than in the finished goods inventory.

During our examinations for fiscal year 1970, we found a substantial improvement in the compliance with our previous recommendations that related labor and overhead be included in the work-in-process inventory. In our latest examination we found that only the tire and cable factories at Petersburg, Virginia, and the furniture factory at Texarkana, Texas, had not included these costs in their work-in-process inventory. We suggest that these industries be required to include such costs in the work-in-process inventory in accordance with the instructions issued in May 1970 by the central office.

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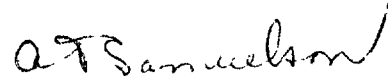
We shall appreciate being advised of any action taken or proposed in connection with the foregoing matters. Also we shall be pleased to discuss these matters with you and officials of FPI at your convenience. The courtesy and

B-114826

cooperation given to our representatives during our examination are appreciated.

A copy of this letter is being sent to the Assistant Attorney General for Administration and to your Associate Commissioner.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "A. T. Samuelson".

Director, Civil Division

The Honorable Norman A. Carlson
Commissioner, Federal Prison
Industries, Inc.
Department of Justice